

## Turkey: Is deeper easing on the way?

We expect a 200bp cut on 25 July, though given increasing concerns about credibility, with the appointment of the new Governor, risks are to the downside. Remarks on economic activity and inflation, along with an emphasis on a reasonable rate of real return, the CBT is signalling deeper cuts until the year-end



### CBT to begin easing in July

At the rate setting meeting on 25 July, we expect the Central Bank of Turkey to start an easing cycle and to come up with a 200bp rate cut given improvements in inflation and new Governor, Murat Uysal's remarks on 15 July. This is aligned with a Reuters survey (vs around 400bp priced in the market according to the swap curve), up from 100bp before the change in the CBT management.

### "Room to manoeuvre" with improving inflation

In an interview, Governor Uysal supports this view as he sees "room for manoeuvre in monetary policy" on the back of:

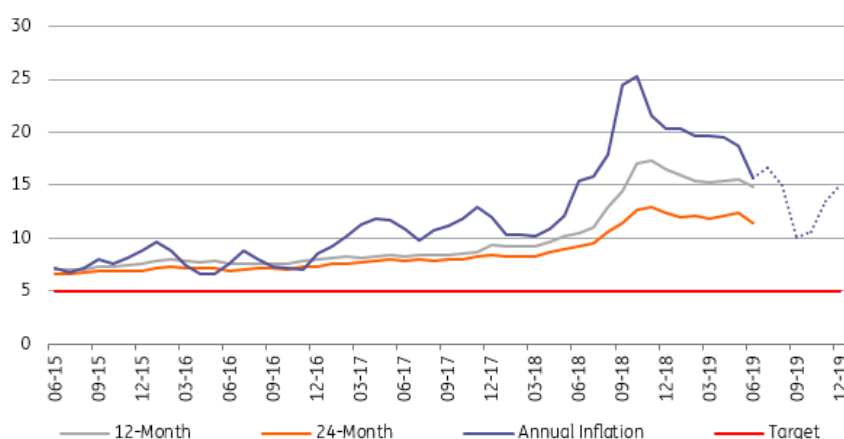
1. The downtrend in inflation: In fact, the most recent inflation data hints at improving price pressures with a downside surprise in recent months, reflecting the weakness in domestic demand and the CBT's tight policy, despite the volatile course of the exchange rate and still

high services inflation

2. Improving inflation expectations: The ongoing disinflation has also contributed to a recovery in inflation expectations given that according to the CBT's latest survey, 12M and 24M expectations have maintained a downtrend due to the backward-looking nature of expectations formation with the former down to 14.8% (from the highest since late 2003 at 17.4% in Nov-18) and latter to 11.5% (from 13%, an all-time high since the start of data collection in Mar-06).

So, in tandem with the expected fall in annual inflation, inflation expectations should recover further in the period ahead.

## Inflation Expectations (%)



Source: TurkStat, ING Bank

## The CBT to maintain "a reasonable rate of return"

The Governor also provides some further guidance regarding policy making that can be seen as evidence of a deeper than expected easing until the end of the year. In this regard he states that:

**1) "The design of monetary policy will be based on a data-focused approach that takes into account all macroeconomic indicators, primarily inflation and economic activity."**

The Turkish economy remained on a rebalancing track in 1Q, with ongoing weakness in domestic demand despite strong public consumption and contributions from exports. The recent early indicators give encouraging signals in June with improving consumer and business confidence indices, rising PMI to the highest level in a year, higher capacity utilisation rate etc.

However, the recovery will be gradual and take time as the expanding budget deficit this year suggests that public consumption growth cannot be sustained, while loan growth has already lost some momentum. Given the focus on the activity along with a likely tightening in fiscal policy, the easing cycle in monetary policy may be larger to support the growth outlook.

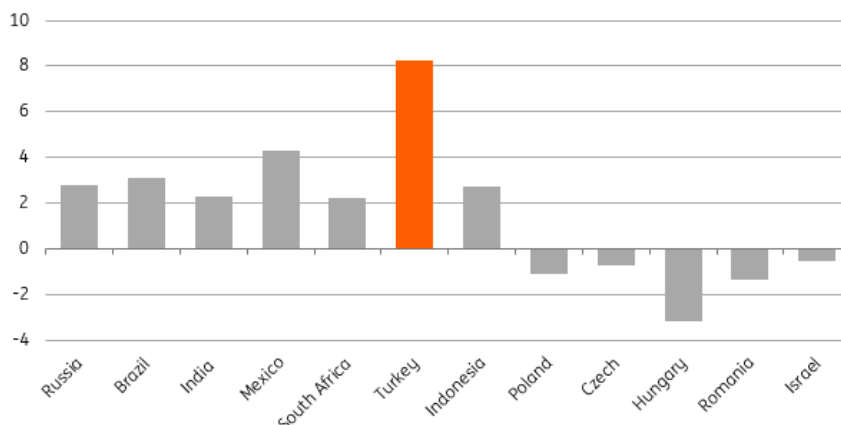
**2) "...(the CBT) will develop a framework that is built upon both expectations and our own projections and maintains a reasonable rate of real return."**

The ex-post real policy rate that had been low or sometimes even negative since the global crisis

currently stands more than 800bp, above that of many emerging market peers. Sensitivity to shifts in global risk appetite, the still high-risk attitude towards Turkey due to geopolitical factors and lower credit ratings call for high real rates. Given the average ex-post policy rate for EM peers of around 300-400bp, and year-end inflation forecast below 15.0%, there is room for the CBT to come up with deeper cuts if geopolitical risks are managed and prudent policies are introduced in the aftermath of local elections.

## Current real policy rates in EMs (%)

(we use 3m Bubor as a policy rate for Hungary)



Source: Bloomberg, ING

## Markets are pricing a large easing until year-end

So, we now see a cumulative 500bp in cuts by the end of this year, while markets are already pricing larger easing. On the flip side, reviving currency volatility impacting the disinflation trend would remain a key variable for the CBT in the policy implementation as stated by the Governor that “to achieve an ever-improving inflation outlook it is crucial to maintain a cautious monetary policy”.

Following a significant underperformance, TRY has been strengthening recently, though the recovery seems to be quite fragile. So, sensitivity of the TRY to geopolitical news flows and domestic issues keeps the CBT cautious and requires a well-calibrated monetary policy to avoid currency volatility.

Overall, the CBT Governor’s remarks suggest that the CBT was encouraged by the down-side surprises in the recent inflation data, while the pace of disinflation provides confidence for the timing of the policy easing in July.

So, a better than expected inflation outlook, more accommodative policy signals from global central banks, TRY strengthening and the contribution of declining geopolitical risk anticipation are all likely to encourage the CBT to start the easing cycle this month. We expect a 200bp cut on 25 July, though given the market’s increasing concerns about credibility with the appointment of the new Governor, risks are to the downside. Also, remarks on economic activity and inflation along with an emphasis on “a reasonable rate of real return”, the bank is signalling deeper cuts until the end of the year.

## Author

### Muhammet Mercan

Chief Economist, Turkey

[muhammet.mercan@ingbank.com.tr](mailto:muhammet.mercan@ingbank.com.tr)

## Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. (“ING”) solely for information purposes without regard to any particular user’s investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies).* The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit [www.ing.com](http://www.ing.com).